SURREBUTTAL TESTIMONY

OF

KEVIN C. HIGGINS

ON BEHALF OF

SOUTH CAROLINA MERCHANTS ASSOCIATION

DOCKET NO. 2002-223-E

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Kevin C. Higgins, 39 Market Street, Suite 200, Salt Lake City, Utah, 84101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING IN THIS PROCEEDING?

A. My testimony is being sponsored by the South Carolina Merchants Association ("Merchants Association").

Q. HAVE YOU ALREADY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I have.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to the rebuttal testimony of SCE&G witness John R. Hendrix, as well as to a point discussed in the direct testimony of Wal-Mart witness James W. Stanway.

Q. WHAT IS YOUR REBUTTAL OF MR. HENDRIX?

A. There are three points discussed by Mr. Hendrix to which I am responding: (1) His defense of SCE&G's rate spread; (2) The purpose of Rate 21; and (3) The addition of a declining tailblock for Rate 20.

Q. WHAT IS YOUR RESPONSE TO MR. HENDRIX'S DEFENSE OF SCE&G'S RATE SPREAD OFFERED IN HIS REBUTTAL TESTIMONY?

A. Mr. Hendrix justifies charging rates to the Medium customer class that are significantly above cost-of-service and which will result in a relative return ratio of 109 percent on the grounds that Medium customers were overcharged in the last rate case as well, and over time the class gravitated closer to its cost-of-service (i.e., from 106 percent to 101 percent). Mr. Hendrix apparently believes that this pattern will be repeated, and so the Company is proposing a plan to deliberately skew rates today in the apparent belief that this will result in a movement toward cost-of-service rates five or so years from now.

Q. DO YOU THINK THIS IS A REASONABLE APPROACH TO RATE SPREAD?

A. Not at all. The standard practice across the country is to set rates that are just and reasonable at the time the rates take effect. Deliberately skewing rates in the near-term in the belief that years down the road they might be better aligned with cost-of-service is a very unconventional approach to rate spread and is fundamentally unreasonable. The emphasis should be on paying cost-based rates *today* – not aiming for the *possibility* of migrating to cost-based-rates five years from now. If for some reason, rates should become misaligned five years from now, the problem can be addressed at that time. The significant increase being requested by the Company today is painful enough for customers; asking one class of customers to pay significantly more than their fair share in the upcoming period is simply unjust.

Q. DO YOU HAVE ANY OTHER COMMENTS WITH RESPECT TO MR. HENDRIX'S DISCUSSION OF DELIBERATELY SETTING RELATIVE RATES OF RETURN THAT ARE ABOVE COST-OF-SERVICE?

A. Yes. As indicated above, Mr. Hendrix states that in the last rate case, the Medium customer class was assigned rates that resulted in a relative return ratio of 106 percent, and in the last cost-of-service analysis, this ratio had come down to 101 percent. Consequently, SCE&G feels it is necessary to bump these customers back up to 109 percent. What I discern here is a deliberate attempt to keep these customers paying rates above their cost-of-service on a *permanent basis*. The movement from 106 percent to 101 percent since the last rate case is an indicator of a multi-year subsidy. Moving these customers up to 109 percent in this case is an attempt to perpetuate that subsidy. The Company does not even make an attempt to ensure that any overcharges to the Medium class in the near-term are balanced by below-cost rates later on. Instead, these customers are apparently expected to always pay rates that are above their cost-of-service. Such a policy is inequitable on its face.

Q. ARE THERE OTHER RISKS ASSOCIATED WITH THE COMPANY'S PROPOSED RATE SPREAD?

A. Yes. Moving these customers to 109 percent today introduces the risk that over time they will move even further away from cost-of-service by the time of the next rate case, worsening the subsidy and making it harder to rectify. That is a major reason why customer classes are almost always moved *toward* cost-of-service in rate cases – not away from it.

Q. WHAT IS YOUR RESPONSE TO MR. HENDRIX CONCERNING THE ROLE OF RATE 21?

A. Mr. Hendrix and I have found some common ground. We both agree that Rate 21 (TOU) as currently designed is not beneficial for high-load-factor customers. In addition, I agree with his correction to my statement that a 100 percent load factor would pay from 6.7 to 7.3 percent more on rate 21 than Rate 20. The correct range is 2.8 to 3.2 percent.

The issue of disagreement here is policy: should Rate 21 be designed to entice more medium-sized customers to TOU rates? This can be accomplished by making the rate attractive for all customers that make efficient use of SCE&G's system during off-peak periods, including high-load-factor customers. SCE&G readily admits that high-load-factor customers benefit the system, lowering the average cost per kwh. Many other utilities, including neighboring Georgia Power, offer TOU rates that are designed to be attractive to high-load-factor customers. In contrast, SCE&G's Rate 21 is decidedly unattractive for such customers. Indeed, Rate 21 appears to be under-utilized, attracting only 4 percent of the Medium customer load, which raises questions about the rate's overall effectiveness in helping to meet the Company's pricing objectives. I continue to recommend that the Commission implement a policy to make TOU prices more widely available to customers in the Medium class by making it attractive for high-load-factor customers to switch to Rate 21.

Q. WHAT IS YOUR RESPONSE TO MR. HENDRIX'S DISCUSSION OF YOUR PROPOSAL TO ADD A DECLINING TAILBLOCK FOR RATE 20?

A. Mr. Hendrix objects to setting a declining tailblock at the same level as the Rate 23 energy charge, but he did not indicate that he disagreed with the declining tailblock concept. I continue to believe that the revenue-neutral change I proposed is appropriate, but I am open to alternatives that give some recognition of a volume-based unit cost reduction.

Q. WHAT ASPECT OF MR. STANWAY'S TESTIMONY ARE YOU REBUTTING?

A. Mr. Stanway discusses SCE&G's proposal to the increase the relative return ratio for the Medium class from 101 percent to 109 percent. He states that he understands this increase is "due to the medium-sized customers' coincident peak (CP) demand increased from the last rate proceeding by 38%, the largest increase of any class." He concludes: "Therefore, from a cost causation standpoint, it is appropriate to allocate the revenue increase as proposed."[1]

Q. WHAT IS YOUR RESPONSE TO MR. STANWAY'S STATEMENT?

A. Apparently, Mr. Stanway is restating a position provided by SCE&G to the Merchants Association in a data response.[2] According to SCE&G, the demand of

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[1] Direct testimony of James W. Stanway, p. 4, lines 19-24.

[2] SCE&G Response to Merchants Association 1-6 states, in part: "In regards to the medium general service class, moving their relative return from 101% to 109% was partly due to the fact that their CP demand

the Medium class during the system peak increased 38 percent since 1995. Indeed, except for Street Lighting, each class's demand during system peak grew, with overall retail demand during the peak increasing 28 percent.[3] But in relying on the Company' data response in coming to his conclusion, Mr. Stanway completely misses the point. Growth in a class's peak demand since the last rate case does not justify charging that class more than its cost-of-service. *The impacts of the increases in coincident peak demands for each of the customer classes are already captured in the Company's cost-of-service analysis*. That analysis allocates demand-related costs to each class based on its contribution to the system peak during the test year. Any increase in rates to the Medium class that is attributable to the growth in that class's peak demand *is already built into the Medium class's revenue requirement and is* ***completely paid for*** *at a relative return ratio of* ***100*** *percent.* Charging the Medium class rates that result in a relative return ratio of **109** percent is simply an attempt to extract a subsidy from Medium-sized customers. Citing the increase in peak demand as justification for this subsidy is a groundless pretext for this overcharge and is without merit.

Q. WHAT IS YOUR RECOMMENDATION TO THE COMMISSION ON MR. STANWAY'S STATEMENT?

A. Mr. Stanway is wrong when he states that it is appropriate, from a cost causation standpoint, to allocate the revenue increase as proposed by SCE&G. His position on this point should be rejected by the Commission.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

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increased from the last rate proceeding by 38%, the largest increase of any class. Therefore, from a cost causation standpoint, it is appropriate to allocate the revenue increase as proposed."

A. Yes, it does.

[3] SCE&G Response to SCEUC 1-4(c).